IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 100

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, entered in the above entitled case on January 20, 1964.

OPINIONS BELOW

The opinion of the Securities and Exchange Commission (J.A. 3a-37a) is not yet reported. It is printed as Appendix B hereto. The opinion of the Court of Appeals, which is also not yet reported, is printed as Appendix A hereto.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1). The judgment of the Court of Appeals was entered on January 20, 1964.

QUESTION PRESENTED

Section 3(c) of the Investment Company Act of 1940 states that "any . . . insurance company" is not an investment company and hence is not subject to the provisions of the Act. "Insurance company" is defined by the Act as "a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State. . . ." It is conceded that petitioner is such a company and is, therefore, entitled to the section 3(c) exemption. The question is whether, despite the exemption, the offer and sale by petitioner of variable annuity contracts, which are "securities" within the meaning of the Securities Act of 1933, would result in some way in the creation of an investment company subject to the 1940 Act.

STATUTES INVOLVED

The definition of "investment company" is set forth in Section 3 of the Investment Company Act of 1940 (54 Stat. 797, 15 U.S.C. Sec. 80a-3), the relevant portions of which are quoted below. Other relevant definitions, contained in Section 2(a) of the Act are also set forth below.

> Sec. 3. (a) (54 Stat. 797, 15 U.S.C. 80a) When used in this title, "investment company" means any issuer which—

(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

As used in this section "investment securities" includes all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which are not investment companies.

* * * * * *

(c) Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this title:

* * * * * *

(3) Any bank or insurance company; any savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution, or any receiver, conservator, liquidator, liquidating agent, or similar official or person thereof or therefor; any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator,

or guardian; or any common trust fund or similar fund, established before the effective date of the Revenue Act of 1936 by a corporation which is supervised or examined by State or Federal authority having supervision over banks, if a majority of the units of beneficial interest in such fund, other than units owned by charitable or educational institutions, are held under instruments providing for payment of income to one or more persons and of principal to another or others.

SEC. 2. (a) (54 Stat. 791, 15 U.S.C., 80a-2(a)) When used in this title, unless the context otherwise requires—

* * * * * *

(8) "Company" means a corporation, a partnership, an association, a joint-stock company, a trust, a fund, or any organized group of persons whether incorporated or not; or any receiver, trustee in bankruptcy or similar official or any liquidating agent for any of the foregoing, in his capacity as such.

* * * * * *

(17) "Insurance company" means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such.

* * * * * *

(21) "Issurer" means every person who issues or proposes to issue any security, or has outstanding any security which it has issued.

* * * * * *

(27) "Person" means a natural person or a company.

STATEMENT

At issue in this case is the applicability of the Investment Company Act of 1940 in circumstance where petitioner, which is concededly excluded from the provisions of that Act by the "insurance company" exemption, proposes to issue variable annuity contracts, which are concededly "securities" within the meaning of the Securities Act of 1933. The relevant facts are as follows:

Petitioner, a mutual life insurance company incorporated in the State of New Jersey, has for many years been in the business of providing both individuals and groups with several types of insurance protection, including life insurance, annuities, and accident and health insurance. Since 1954 it has been interested in offering a relatively new and highly significant form of retirement income protection commonly known as the variable annuity.

Basically, the objective of a variable annuity is to provide a retirement income that offers some prospect of keeping pace with changes in the cost and standard of living. Under the contract, contributions by contract-holders are invested in a portfolio of equity securities, and both the purchaser's interest in the contract during the accumulation period and the annuity payments made thereafter vary in value in accordance with the investment results of the portfolio. While no guarantee of investment results is provided, the insurance feature of the plan is the guarantee that the current value of a determinable number of annuity units will be paid for the lifetimes of the recipients, regardless of the individual or collective longevity of the annuitants. Such a contract provides a form of retirement income protection that ordinary annuity

policies do not, and for this reason petitioner has devoted considerable time and effort to the development of an actuarially sound variable annuity program.[1]

In the course of petitioner's preparation of such a program, it became evident that the insurance laws in the state of petitioner's incorporation would have to be modified in certain respects to enable petitioner to engage in the variable annuity business.[2] The New Jersey legislature over the course of four years extensively considered petitioner's proposed variable annuity program, and in 1959 it passed enabling legislation which included carefully designed regulatory provisions.[3]

While petitioner was taking these steps required of it because of the existing character of state legislation, two other—and quite different—companies became engaged in litigation leading to a decision by this Court that is of considerable importance in the case at bar.

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[1] The variable annuity contract may take a number of different forms and it would not be relevant to set forth in detail the various provisions of the contracts petitioner wishes to offer. Good descriptions of the basic features of a typical contract are given in the opinions of this Court in *S.E.C. v. Variable Annuity Company*, 359 U.S. 65. See also the opinions below at pp. 7a and 22a, *infra*.

[2] Since it was considered desirable, in administering variable annuity contracts, to maintain the net proceeds of the payments made by variable contract holders in a segregated account, thus providing a convenient means for measuring and defining the values of the payments to be made under the variable contracts, petitioner sought legislation authorizing the creation of a segregated account by life insurance companies.

[3] The legislation is codified as Revised Statutes of New Jersey, Sections 17:35A-1 through 17:35A-13. Amendments were also made to Sections 17:34-19 and 17:34-24.

These companies—Variable Annuity Life Insurance Company of America (VALIC) and The Equity Annuity Life Insurance Company (EALIC)—were newly organized corporations, licensed as insurance companies in the District of Columbia, whose primary purpose at that time was to engage in the sale of variable annuity contracts. When they began to offer such contracts to the public, the Securities and Exchange Commission instituted an action in the United States Court for the District of Columbia seeking to restrain the sales.[4] The Commission asserted that the contracts were securities within the meaning of the Securities Act of 1933 (hereinafter referred to as the "1933 Act"), and consequently that they had to be registered under that Act and that the companies were obliged to register as investment companies under the Investment Company Act of 1940 (hereinafter referred to as the "1940 Act").

The Commission lost in the District Court and in the Court of Appeals, but prevailed in this Court. *S.E.C. v. Variable Annuity Co.*, 359 U.S. 65.

Following that decision, VALIC and EALIC filed applications to the Commission under Section 6(c) of the 1940 Act requesting exemption from various provisions of that Act. On February 25, 1960, the Commission entered orders granting in part and denying in part the requested exemptions. *Variable Annuity Life Insurance Company of America*, 39 S.E.C. 680; *The Equity Annuity Life Insurance Company* 39 S.E.C. 674).

Thereafter petitioner also filed an application with the Commission; but, because of petitioner's concep-

[4] The action was brought against VALIC, and EALIC intervened as a party defendant.

tion of the requirements of the 1940 Act, its application was not simply or primarily a request for exemption. Petitioner concluded that the variable annuity contracts which it proposed to offer to individuals were similar to the VALIC and EALIC contracts and hence that they were to be regarded as "securities" within the meaning of the 1933 Act. Consequently, petitioner was entirely willing to comply with all of the provisions of that Act.[5] However, petitioner believed that its offer and sale of variable annuity contracts would not subject it in any way to the provisions of the 1940 Act because, in contrast with VALIC and EALIC, petitioner was, and would continue to be, engaged primarily in the writing of other types of contracts that were concededly insurance policies, so that petitioner was an "insurance company" and therefore not an investment company subject to the Act.

Because the staff of the Securities and Exchange Commission took a different view, and so that the question might be settled authoritatively, petitioner sought an order pursuant to Sections 3(b)(2), 3(c)(3) and 38(a) of the Act that in substance would have declared that the issuance by petitioner of its proposed variable annuity contracts would not bring into play the provisions of the Act because of the Section 3(c)(3) exclusion of insurance companies. Petitioner also requested in the alternative, but only in the event the principal application was denied, that exemption be granted from certain provisions of the Act.

[5] Petitioner proposed also to offer two basic forms of group variable annuity contracts. The court below, after noting that the Commission is dealing with the problems caused by the group contracts in its administrative capacity and that it had excluded such problems from the scope of its opinion, stated, "Accordingly, we do likewise." (p. 1a, *infra*).

On January 22, 1963, the Commission denied the primary application and also in principal part the secondary application. As to the primary application, the Commission acknowledged that petitioner was an insurance company as defined in Section 2(a)(17) of the Act and, therefore, was not an investment company by reason of the Section 3(c)(3) exception. However, resting upon the Section 2(a)(8) definition of company as including ": . . a trust, a fund, or any organized group of persons whether incorporated or not . . ;" the Commission held that an "unincorporated investment fund [would be] created out of the proceeds of the sale of the proposed variable annuity contracts," that the "contracts created a 'trust' in the hands of Prudential for the contract holders," that the variable annuity contracts "constitute the holders [of the contracts] an 'organized group of persons,'" and that the "fund," "trust," and "organized group" would constitute an investment company subject to the Act (J.A. 16a-17a, *infra* p. 23a). Putting it somewhat differently, the Commission held that "Prudential is not itself an investment company but is the creater of one . . ." (J.A. 10a, *infra* p. 17a) and that the issuance by petitioner of variable annuity contracts would "create a relationship subject to the Act" (J.A. 9a, *infra* p. 17a).

In so ruling, the Commission rested heavily upon the decision of this Court in *S.E.C. v. Variable Annuity Co., supra*. According to the Commission, its decision stemmed from "the basis and logic of the Supreme Court's decision in the *VALIC* case" (9a-10a); and the principles it applied "flow from the decision" in that case (J.A. 14a, *infra* p. 21a).

Petitioner sought review only of the denial of the primary application. Although petitioner disagreed

with the determination of the Commission with respect to the exemptions requested in the alternative application. Section 6(c) of the 1940 Act explicitly committed these matters to the Commission's discretion and petitioner could not fairly assert that the Commission had abused that discretion.[6] Thus there was presented to the Court of Appeals solely a question of law—the correct interpretation of Section 3 of the 1940 Act, which defines the jurisdiction of the Commission and the coverage of the Act.

The Court of Appeals affirmed the order of the Commission in an opinion that adopted, virtually without change, the reasons given by the Commission for its decision.

REASONS FOR GRANTING THE WRIT

1. The question presented here was not, and could not have been, raised or decided in *S.E.C. v. Variable Annuity Co.*, 359 U.S. 65. Yet both the Commission and the Court of Appeals, in relying heavily upon that decision, misread and misapplied it.

The respondents in *Variable Annuity Co.* were two corporations admittedly engaged primarily and predominantly in the business of issuing variable annuity contracts, although they also offered conventional life insurance policies. The issues were whether these contracts were securities within the meaning of the 1933

[6] Section 6(c) provides: "The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title."

Act and whether the corporations were investment companies subject to the 1940 Act. These issues turned entirely upon whether the variable annuity contracts fell within the Section 3(a)(8) "insurance or endowment policy or annuity contract" exemption of the 1933 Act. If they did, obviously not only the 1933 Act but also the 1940 Act would have been inapplicable, since then respondents would plainly have been companies whose "primary and predominant business activity" was the issuance of insurance policies.[7] On the other hand, if the contracts did not fall within the 1933 Act's insurance policy exemption, then it was equally plain that the companies were investment companies within the meaning of the 1940 Act, since in that case the companies' primary and predominant activity would concededly be the issuance of securities. Thus, the determinative question, as phrased by the Court, was simply "whether respondents are issuing contracts of insurance," 359 U.S., at 68.

The Court decided this question against respondents, holding that the contracts were securities and not insurance policies or annuity contracts as those terms are used in the 1933 Act. It held, accordingly, that respondents were investment companies under the 1940 Act. But the Court had no occasion to and did not discuss the question, irrelevant in that case but controlling here, whether the 1940 Act would have

[7] Section 2(a)(17) defines an insurance company as a company "whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State. . . ." There was no dispute that VALIC and EALIC were subject to supervision by the insurance commissioner of the District of Columbia, the jurisdiction of their incorporation.

been applicable even if respondents' primary and predominant business activity had been the writing of insurance.

Nonetheless, as we have indicated, the Commission purported to rest its decision upon the "basis and logic" of *Variable Annuity Company*, and the Commission's approach was accepted by the lower court. More specifically, the Commission stated that the basis of this Court's decision in *Variable Annuity Company*, as applicable to the case at bar, consisted of an analysis of "the variable annuity contract, its provisions, its impact, and the relationship of the holders of such contracts to the fund" (J.A. 15a, *infra* pp. 21a-22a).

The critical phrase in this description of this Court's decision is "the relationship of the holders of such contracts to the fund." As we have stated, the Commission and the Court concluded that the issuance of the contracts by petitioner would create a "fund" that would be an investment company; and, as the quotation above indicates, this holding was purportedly based upon the decision and analysis in *Variable Annuity Company*. But this is a plain misreading of the opinion in that case. At the time of *Variable Annuity Company*, the concept of a "fund" that would be independent of the respondent companies and that could be the "issuer" of the variable annuity contracts had not yet occurred to anyone, and there is no suggestion of such a notion in any of the opinions of this Court or, for that matter, in any of the briefs.

Indeed, far from being approved, or even suggested, by the decision in *Variable Annuity Company*, the "fund" (or "trust" or "unorganized group of persons") notion is in fact inconsistent with that decision.

Under Section 3(a) of the 1940 Act, the investment company subject to the Act must be the "issuer" of the securities in question. In *Variable Annuity Company*, this Court held that the issuers of the variable annuity contracts were the respondent corporations, not some "fund" that resulted from the sale of the contracts. In the case at bar, in contrast, the Commission and the lower court have held that petitioner will *not* be the issuer of its proposed variable annuity contracts, but rather that the issuer will be a "fund" which automatically comes into being when the business of offering these contracts is begun.

Turning to what actually does appear in the opinions in *Variable Annuity Company*, it is difficult to see how the Commission's position is advanced. So far as Mr. Justice Douglas' opinion for the Court is concerned, while naturally it contains an analysis of "the variable annuity contract, its provisions, [and] its impact," as the Commission says, this analysis was devoted entirely to ascertaining whether the contracts were securities or insurance policies.[8] And while it may be that certain of the portions of Mr. Justice Brennan's concurring opinion, which examines the regulatory purposes of both the 1933 and 1940 Acts, discusses matters which should also be considered in the case at bar, see *infra*, pp. 19-26, that opinion was directed at the question raised in that case, which, as we have demonstrated, is far different than the question in-

[8] Except as it was necessary to phrase the issues, therefore, there was no mention whatever in the opinion of the Court of the provisions of the 1940 Act. There was and could have been no contention in that case that the 1933 Act could be applicable and the 1940 Act inapplicable.

volved here.[9] As we show below, the holding of the Commission in this case effectively forecloses established insurance companies from the variable annuity business, raises important questions of conflict between state and federal regulation, and is highly questionable (and we think erroneous) as a matter of statutory construction. None of these difficulties were present in this form in *Variable Annuity Company*, so that the Commission and lower court were wholly without warrant in relying upon that decision.

2. If allowed to stand, the interpretation given the 1940 Act by the Commission and the lower court will have far reaching consequences with respect to the relationship between federal and state regulation and with respect to the exclusion of established insurance companies from the variable annuity business. Moreover the decision will serve to freeze the form which this newly developed means of providing retirement income may take.

The Commission recognized that variable annuity contracts contained promises and guarantees involving life contingencies and actuarial computations of a kind which fall within the definition of insurance and which make regulation by state insurance authorities appropriate (J.A. 12a-14a, *infra* p. 18a-20a). It also agreed, for purposes of this case, that the variable annuity was

[9] In addition, it may be observed that since the question in *Variable Annuity Company* was whether both the 1933 and the 1940 Acts were applicable or inapplicable, it cannot be determined how much significance the concurring Justices would have attributed to the policies and purposes of the 1940 Act standing alone had it been conceded, as it is here, that the far more important protections resulting from the applicability of the 1933 Act were in any event to be made available.

a valuable and meritorious means of providing retirement income (J.A. 8a, *infra* p. 15a). It disclaimed any intention to interfere with the scope or the degree of such state regulation that might be deemed necessary (J.A. 10a, *infra* p. 17a). Moreover, the Commission vigorously denied that its decision was in any sense a prohibition of the issuance of variable annuities by any organization (J.A. 11a, *infra* p. 18a).

The necessary effect of its decision, however, is to deny to existing life insurance companies the right to issue and sell variable annuities to the public.[10] The holding of the Commission was that the 1940 Act applies to certain relationships "in whatever form or by whomever created" (J.A. 9a, *infra* p. 16a). It found that such a relationship resulted from the sale of variable annuity contracts, whether by a company formed for that purpose or by a company long engaged in the life insurance business. It went on to hold that the 1940 Act, once such a relationship has been found to exist, requires the formation of a legal entity which would then be one of the parties to this relationship.[11] This legal entity, under the Commission's decision, must be different from and independent of the organization which purported to create the relationship in the

[10] It is noteworthy that except for the respondents in *Variable Annuity Co.* no company is today issuing individual variable annuity contracts.

[11] While the petitioner, pursuant to New Jersey law, has established a segregated account in which the net proceeds of payments made under variable contracts will be placed and invested, the assets of which will be held for the sole benefit of the variable contracts, the Commission made it clear that its decision was not dependent upon this fact but would "apply quite irrespective of state legislation segregating the investment fund. . . ." (J.A. 15a, *infra* p. 23a).

first instance. The new legal entity would have to be provided with a separate board of directors which would be independent of and different from the board of its "parent."[12] It might, if it wished, enter into certain short-term contractual arrangements with its "parent" organization for the purpose of obtaining investment advice and for marketing the variable annuity contracts.[13] But it would be this legal entity, not the "creator" insurance company, that would perform all the investment functions required by the variable annuity contract.

Whatever may be said of this arrangement it cannot be denied that a life insurance company which seeks to offer variable annuity contracts would find itself performing only a partial role, and that many of its functions would be carried on only by sufferance since they could be eliminated when the limited contractual periods permitted by the statute had expired. And even if this arrangement were an acceptable one—which it is not to petitioner and other established life insurance companies, because, first, they are not authorized under state law to make such arrangements and, second, they consider the variable contract to be one of many inter-related forms of income protection which should properly be available from a single company—there is grave doubt that the expense of entry into the business can be justified in the absence of considerably greater assurance that the initial arrange-

[12] Inv. Co. Act, Sections 10, 16.

[13] Inv. Co. Act, Section 15. The parent organization, of course, would have to be provided with statutory authority to enter into such contracts.

ments would have a degree of permanence.[14] None of these problems must be faced, it should be noted, by a newly organized life insurance company, either stock or mutual, which is to confine itself primarily to the business of issuing variable annuity contracts.

In addition to limiting the kind of companies that may issue variable annuity contracts, the Commission's decision, which prescribed in several essential respects the form which these contracts may take, has required the inclusion of contractual provisions which the State of New Jersey had prohibited. Thus, even if petitioner were willing and able in other respects to comply with the decision by establishing a new and independent corporation, that corporation (and any other company desiring to issue variable annuities in New Jersey) would be caught in a conflict between state law and the Commission's decision. An example should suffice for purposes of this petition.

The Commissioner of Banking and Insurance of the State of New Jersey successfully urged upon the State Legislature a statutory provision which forbids a lump sum payment to an individual variable contract holder who chooses to terminate his contract. This provision requires that the value of the contract be paid only pursuant to a plan under which payments will continue for a period of at least three years. The Commissioner of Banking and Insurance explained that this provision was necessary in order to make the

[14] The new entity would be free, for example, under Section 15, to choose a rival insurance company as its investment advisor after giving only 60 days notice. This would create a chaotic condition.

variable annuity contract unattractive to persons seeking a means for the general investment of their funds in equity securities, so that it would be purchased only by persons interested in providing themselves with an income upon retirement (Tr. 495, 526). If the "issuer" of variable annuity contracts is subject to the 1940 Act, however, then so too are the "securities" that are issued. And the Act provides that if a security is redeemable it must be redeemed by the issuer within seven days after demand.[15] The Commission denied a requested exemption from this requirement of the Act, which would have permitted termination payments to be made in installments over a three-year period (J.A. 31a-33a, *infra* p. 38a).[16] Thus we have the unhappy result of, on the one hand, a ruling by the Securities and Exchange Commission that the variable annuity contracts must be made to resemble more closely the shares issued by conventional investment companies, and, on the other hand, a determination by a state legislature, that because of the unique characteristics of this newly developed product, it should be so regulated as to sharply differentiate it from the shares of conventional investment companies.

The Commission and the Court of Appeals have thus imputed to the Congress an intention to impose upon companies desiring to offer products such as the variable annuity the highly unique corporate structure that has been developed by the investment company industry, to limit very sharply any experimentation

[15] Inv. Co. Act, Sections 2(a)(31), 22(e).

[16] As indicated above, review is not sought of this aspect of the Commission's decision. It is referred to only to show the consequences of the Commission's unlawful assumption of jurisdiction under the 1940 Act.

with the form that such a product may take; and to give no heed to the views of the states in these respects. We submit that this is a far-reaching and important construction of the 1940 Act that deserves the attention of this Court, unless the decision below is plainly correct. We now show that it is not.

3. On the face of the statute, it would appear that the insurance company exemption, which concededly applies to petitioner, would permit petitioner to issue variable annuity contracts even though they are securities subject to the 1933 Act so long as petitioner retains its character as an insurance company. Both the Commission and the lower court agree that petitioner is not an investment company. They conclude, however, that the plain meaning of the statutory language exempting insurance companies must be overridden by what they conceive to be the basic purposes and policies of the Act. It is asserted that because the regulatory provisions of the Act are relevant to every arrangement under which a person commits his funds to another to be invested on his behalf in equity securities, the Congress *must* have intended the Act to apply to "such a relationship in whatever form or by whomever created" (J.A. 9a, *infra* p. 16a) or to "such situations regardless of the legal form or structure of the investment enterprise." (Opin. below, *infra* p. 6a).

Entirely apart from the fact that the best place to find Congressional purpose is in the language of the statute, this conclusion does not follow from the premise. The fact that regulatory provisions may be relevant to particular relationships surely does not require the conclusion that those provisions were intended to be applicable. There may well have been weightier considerations that led to a legislative decision to ex-

clude such relationships from the scope of the Act. In this case both the Court of Appeals and the Commission have failed to give effect to provisions of the statute and to its legislative history which show conclusively that the Congress did in fact intend to limit the coverage of the Act so as to exclude therefrom many "relationships" or "situations" identical or closely similar to those involved here. Thus there was a Congressional policy quite different from that which assertedly justifies the strained and unnatural meaning that has been given to the Act. More specifically:

(a) The Congress was advised by the Commission, which drafted the 1940 Act, that the Section 3(c)(3) declaration that insurance companies were not "investment companies" was designed particularly to cover fire insurance companies.[17] This was because the business of a fire insurance company, from the point of view of the stockholders who invest in the enterprise rather than the policyholders who purchase insurance, is primarily that of investing and reinvesting in investment securities and only secondarily the underwriting of risks involving the destruction of property by fire.[18] Notwithstanding the presence of this relationship, the Act was explicitly made inapplicable;

(b) Section 3(c)(13) states that "any employees' stock bonus, pension, or profit sharing trust which meets the conditions of Section 165 of the Internal Revenue

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[17] Hearings Before a Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 2d Sess. (1940), p. 181.

[18] This was well known to the Commission, which so advised the Congress. "The Nature, Classification and Origin of Investment Companies." H. Doc. No. 707, 75th Cong., pp. 38-39. See, also, J.A. 126a-129a.

Code as amended" is not an investment company within the meaning of the Act. Such trusts, particularly when employed in connection with contributory retirement plans which permit contributions by employees, provide a means by which individuals may commit their funds to a trustee to be pooled and invested in equities on their behalf with the amount of their benefits dependent upon the success of the investment program. Yet Congress expressly excluded this "relationship" from the 1940 Act by Section 3(c)(13).

(c) As part of its study of the investment company industry which led to the adoption of the 1940 Act, the Commission prepared a special report describing the activities of common trust funds.[19] In the report's words, "these funds are an investment vehicle akin to the investment company of the general management type," having as their purpose "the procurement of an adequate diversified investment medium for the small investor" by the combination of "a number of small personal trusts or estates of which a bank or trust company is the trustee into one larger fund for common administration by the bank or trust company in its trustee capacity."[20] Thus, although these funds were functionally indistinguishable from investment companies, they were excluded from the coverage of the Act. If Congress had genuinely adopted as its guide the "re-

[19] "Commingled or Common Trust Funds Administered by Banks and Trust Companies." H. Doc. 476, 76th Cong.

[20] Id., at pp. 1, 3. See, also, the specific similarities between common trust funds and management investment companies described at pp. 7-11 of the report. It was reported that about half of the funds studied restricted participation to revocable *inter vivos* trust estates created specifically for the purpose of participating in the fund.

lationship" approach attributed to it by the Commission, there would be no adequate explanation for the common trust fund exemption.

The Commission and the Court of Appeals assert that this exemption was provided because "common trust funds were used for bona fide fiduciary purposes . . . and had only a limited impact in the investment fund picture." (Opin. below, *infra* pp. 9a-10a). Apart from the fact that every investment company stands in a fiduciary capacity, which presumably is bona fide, to the shareholders who have entrusted it with their funds, the difficulty is that this is only a possible explanation for the exemption and not the explanation given in 1940 by the Congress or the Commission.

(d) In the opening section of its general report to the Congress on investment trusts, the Commission set forth a detailed "case history" of the Massachusetts Hospital Life Insurance Company as an illustration of "the process by which a life insurance company branching out into more or less related fields gradually assumed many of the characteristics of an investment company." The report's description of this process makes it plain that there was no thought that, when an insurance company first began to issue investment contracts, thereby creating a "relationship" of the type which the Commission now says is always subject to the Act, there would be created a "fund" separate and independent of the insurance company. On the contrary, the plain import of the description in the Commission's report is that it was only when the securities business of the company predominated over its insurance business that there would be an "in-

vestment company" subject to regulation under the Act.[21]

(e) The conventional fixed-dollar annuity contract provides for periodic payments by the contract holder and for a "cash surrender value" which may be taken by the contract holder in lieu of the lifetime annuity payments which are promised by the company. If this contract is analyzed in the same fashion as the Commission has analyzed the variable annuity contract, the contract holder is unquestionably a party to a "relationship" identical to that of the holder of a face-amount certificate, as defined in Section 2(a)(17) of the 1940 Act. The Commission has never asserted that because of the existence of that relationship a "fund" is created which, as the "issuer" of the face-amount certificate that is part of the annuity contract, is an "investment company" by virtue of Section 3(a)(2) of the Act. Any such contention would plainly be inconsistent with the statutory scheme and with the evident intent of the Congress.[22]

These examples suffice to show that the Congress did not intend to subject to the 1940 Act every "rela-

[21] "The Nature, Classification and Origin of Investment Companies," H. Doc. No. 707, 75th Cong., pp. 42-43; see, also, the Commission's Common Trust Fund report (fn. 20, *supra*), at p. 5, fn. 11.

[22] On several earlier occasions the Commission was presented with opportunities to announce the "fund" doctrine which it adopted in this case as the basis for its jurisdiction. It failed to do so in each instance, apparently because it did not occur to anyone that such an analysis of the coverage of the 1940 Act could fairly be made. *See Collateral Investment Company*, 10 S.E.C. 1083 (1942); *American Annuity Savings Association*, 35 S.E.C. 610 (1954); *The Great American Life Underwriters Inc.* (Inv. Co. Act Rel. 3070, July 15, 1960); C.C.H. Fed. *Sec. L. Rep.*, ¶ 76,713, pp. 80681; 80685-7.

tionship" that is similar to that existing between a conventional investment company and its shareholders. There was in fact quite a different Congressional purpose when the Act was drawn. An examination of the legislative history, if made with the objective of determining what the Congress did intend rather than of finding materials to support a conclusion already reached, discloses that the Congressional purpose, although broad with respect to the type of regulation to be enforced, was limited with respect to the objects of that regulation. The Congress had been presented with a history of abuses within a specific industry which called for remedial legislation, and the statute was framed to deal with that industry and not to provide regulation over "relationships," a word not to be found in the statute or in the extensive legislative materials. The broad definition of "company," upon which the Commission and the Court of Appeals relied, was intended to embrace every institution within the industry—however informal its form of organization—and not to impose regulation over activities of companies in industries which were explicitly excluded from the Act.

Congress was concerned with a particular class of companies—the investment companies—which had theretofore been virtually unregulated and many of which had amply demonstrated an incapacity for self-regulation. Congress was not concerned, on the other hand, with the activities of businesses already regulated by the states or the federal government—such as banks and insurance companies—which had not contributed to the destruction of public confidence in the investment company business. This lack of concern was not because Congress was

unaware of the fact that banks and insurance companies might and did engage in activities similar to those engaged in by conventional investment companies. Indeed where certain "relationships" of the kinds that the Commission now asserts are subject to the Act were found to exist under a form of organization that might conceivably have brought them within the coverage of the Act, the Congress took pains to provide specific exemption. The lack of concern with banks and insurance companies was rather because Congress was providing regulation only for certain types of companies—companies which were not then subject to the kind of regulation imposed upon banks and insurance companies.

Throughout the legislative history there are recurrent contrasts between investment companies and banks and insurance companies. These references were invariably for the purpose of demonstrating the need for regulation of investment companies comparable to that already imposed upon banks and insurance companies by the states.[23] And, as we have shown, the Congress specifically contemplated the possibility of exempting businesses engaging in the type of business activity such as that here involved without subjecting themselves to regulation by indirection, at least until the investment activity predominates over the exempted activities. It is difficult to escape the conclusion that the Commission reached its decision because it believed these activities should be subject to its jurisdiction

[23] See, for example, S. Rep. No. 1775, 76th Cong., 3d Sess., p. 10; H.R. Rep. No. 2639, 76th Cong., 3d Sess., pp. 6, 7; The Nature, Classification and Origin of Investment Companies, H. Doc. No. 707, 75th Cong., p. 63; Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce of the House, 76th Cong., 3d Sess., p. 61; 86th Cong. Rec. 10070, 10071.

and not because of any conviction that Congress had so provided. Compare *Blau* v. *Lehman*, 368 U.S. 403, 411-413. Nor is it without significance that since the decision in *Variable Annuity Co.*, the Congress has adopted two Acts relating to variable annuities, both of which recognize that the "issuer" should be treated as an insurance company for purposes of federal law. See Internal Revenue Code, Section 801(g) as added by the Life Insurance Tax Act of 1959, 73 Stat. 114, and Public Law 86-520, 74 Stat. 218, authorizing the establishment of separate accounts for life insurance companies in the District of Columbia which issue contracts on a variable basis.

CONCLUSION

No matter in what legalisms the decisions below be dressed and no matter what disclaimers be issued, in plain language the result is that the Commission has devised a theory under which the development of an important new product—a "security" for purposes of federal law but plainly "insurance" for purposes of state law—will be sharply restricted. We think the Commission's theory is wrong. In any event, it is plainly subject to serious doubt. It is not genuinely open to question that this theory was not approved by this Court in *Variable Annuity Co.* and that it has never before been suggested in any Commission or judicial decision. It is equally clear that it requires a reading of the statute that is highly artificial and at variance with its plain meaning.

Moreover, the result is of considerable significance, not only because of the supersession of state legislation and regulation designed for the protection of the many persons who will purchase variable annuity contracts, or the sharp restrictions of the devel-

opment of this product and its availability to the public, but also because the decisions below rest primarily upon an incorrect reading of a prior decision of this Court bearing upon the critical question of the scope of the Commission's jurisdiction. In these circumstances, we urge that the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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